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## Results of Fiscal Consolidation in Republic of Serbia

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### Abstract

Fiscal adjustment or fiscal consolidation is being performed on both the revenue and expenditure side of the budget. The authorities have at their disposal two instrumental variables available: taxes and public expenditure, divided into public spending, investment and transfer. To be able to achieve the desired effect, fiscal policy aims aligning these instrumental variables that are available to it. However, achieving the proper balance is difficult and it is uncertain which of the two instrumental variables have the strongest effect on economic activity. Traditional Keynesian theory holds that the changes within public expenditure are more effective instrumental variables than tax changes. This is because the concerned procurement of goods and services have a direct impact on GDP, while taxes shows its indirect effect through decisions of households and businesses on consumption and investment. The Serbian Government has taken several measures in recent years, both on the revenue and on the expenditure side of the budget. The main aim of these measures is to reduce the budget deficit and consequently public debt, which is located at an alarming level. The aim of this study is to analyze the effects of the undertaken measures and suggesting possible effective measures to solve these problems.

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*Keywords:* fiscal policy; fiscal consolidation; public expenditure; public revenue; budget deficit.

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### 1. Introduction

Fiscal consolidation is concrete policies aimed at reducing government deficits and public debt. The appropriate amount of fiscal consolidation for each country will depend on a number of factors, including the strength of its

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economy, the public debt and interest developments, the ease of financing debt, and political decisions concerning taxes and spending (OECD Journal on Budgeting, p.17). Depending of undertaken measures there are four categories of countries: 1. Countries that announced substantial consolidation in response to market concerns about public finances: Greece, Hungary, Ireland, Portugal, Spain. 2. Countries that announced pre-emptive packages in terms of relatively sizeable medium-term consolidation: Estonia, Germany, the Netherlands, New Zealand, the Slovak Republic and the United Kingdom. 3. Countries that have comparatively high fiscal consolidation needs but have yet to announce large or more detailed consolidation: France, Japan, Poland and the United States. 4. Countries that have comparatively low fiscal consolidation needs: Australia, Chile, Finland, Korea, Norway, Sweden and Switzerland (OECD Journal on Budgeting, p.21). In this countries fiscal consolidation is weighted on average two-thirds towards spending cuts and one-third towards increasing revenues (*OECD Economic Outlook*). Countries with a low tax burden have greater scope to implement consolidation through revenue measures. This strategy can provide immediate effects, while expenditure-based measures take long time.

Before getting on with designing the program of fiscal consolidation we should answer the following questions: What will be the broadness of the fiscal adjustment? Is it better to cut public spending or increase revenues and which component of the expenditure and revenue should be adapted to the new situation? Will the fiscal consolidation last for longer period of time or will imbalances reappear? Will the fiscal adjustment cause a recession? How will the public react to the proposed and taken measures?

The answers to these questions should create conditions for achieving the main objectives of fiscal consolidation, which are: contribution to the recovery of state finances; strengthening a market-oriented economy; preparing the economy for the fulfilment of the Maastricht criteria; enabling economy for the return of debts.

The Republic of Serbia has very poor macroeconomic performances and it is essential that the government takes measures to block the collapse of the economy and the overall public finances. Government has taken part of the measures in October of 2012 and in the early months of 2013 it has adopted a package of measures to stabilize public finances and economic recovery. Strengthening the economy requires consolidation of public finances and the implementation of fiscal policy. This method is based on the principles of responsible fiscal management and fiscal rules, which strengthen fiscal discipline, improve fiscal coordination between different levels of government, reduce fiscal risks and ensure long-term fiscal sustainability (Fiscal Strategy, p.4). Previous measures were mainly focused on the revenue side of the budget, i.e. the government has increased the tax rate in most of the taxes, while the main focus of new measures will be directed on the expenditure side of the budget, in the order to achieve their significant reduction.

The writing of this paper included usage of numerous web sites of competent institutions: the OECD, the EU, the National Bank of Serbia, the Ministry of Finance of the Republic of Serbia and the Fiscal Council of the Republic in order to provide current information, necessary for the analysis of such complex issues.

## **2. Macroeconomic indicators and composition of public expenditures and revenues in the Republic of Serbia**

In the pre-crisis period, all the major indices had a positive trend. However the situation has significantly deteriorated during the crisis. Some variables even have recorded an alarming values, so that the government was forced to undertake a series of measures to consolidate public finances. To see whether the actions taken have achieved the desired goals, we will first give a basic overview of economic indicators (Table 1).

Based on the data from Table 1 we can see that the wave of the economic crisis swept the Serbian economy in 2009. In this year economic growth rate was negative (-3.5%). As a result there was a large increase in unemployment, which reached a peak during the year 2012, when the unemployment rate reached a value of 23.9%. These are also the two biggest problems that have caused numerous others, and until they are not resolved we can not talk about the recovery from the crisis. The highest level of GDP per capita was recorded in 2008 and it was almost € 4.500. Unfortunately, this amount has not been reached until today. As for the rate of inflation, it was very variable and unstable. The highest rate was recorded in 2012 (12.2%), and the lowest in following 2013 (2.2%). From 1. January 2009 the National Bank of Serbia began with the application of explicit monetary strategy – the inflation targeting. All these years, the actual rate of inflation was mainly out of inflation corridor, but it should be noted that only in 2013 inflation rate was below the lower limit, which on our area hasn't been recorded in the entire post-war history. Situation in the balance of payments significantly depends on the amount of remittances of persons who are temporarily working abroad and which send money to their families. Thus, generally speaking, the

key macro-economic indicators in Serbia during the analyzing period had poor performances. Consequently, we can not expect good results in the field of public finance.

Table 1. Key macroeconomic indicators in Serbia, 2007-2013

Year	Real growth of GDP (%)	GDP per capita (EUR)	Consumer price index - CPI (%)	Unemployment rate (%)	Deficit/surplus in the balance of payments (mil.EUR)
2007	5,4	3.857	11,0	18,1	742,1
2008	3,8	4.446	8,6	13,6	-1.686,6
2009	-3,5	3.954,7	6,6	16,1	2.363,5
2010	1,0	3.835,7	10,3	19,2	-928,7
2011	1,6	4.350,6	7,0	23,0	1.801,5
2012	-1,5	4.111,8	12,2	23,9	-1.137,2
2013	2,0	-	2,2	20,1	-

Source: Bulletin of Public Finance, January 2014 Ministry of Finance of the Republic of Serbia, p.16-21

In order to comprehend what the current situation in our country is, we will analyze the scope and structure of the consolidated revenues and expenditures.

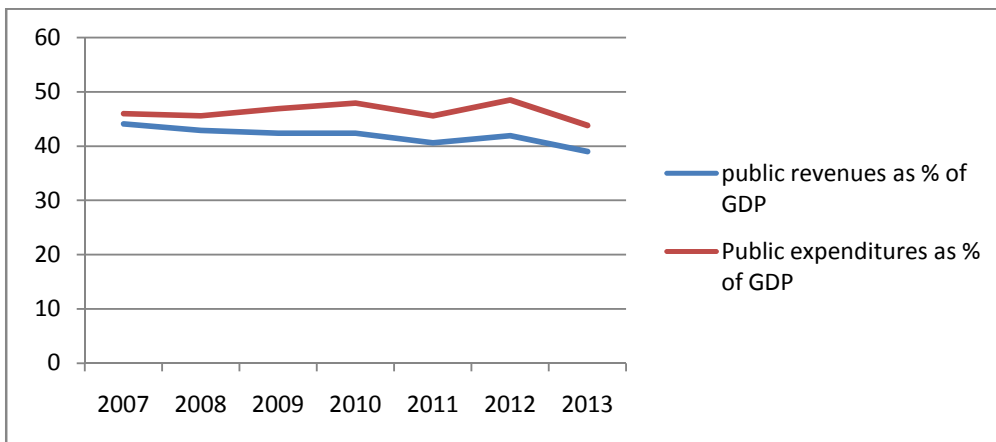


Figure 1. The consolidated public revenues and expenditures as% of GDP in Serbia, 2007-2013

Source: Bulletin of Public Finance, January 2014 Ministry of Finance of the Republic of Serbia, p.16-50, calculations have been carried out by authors

From the Fig. 1 can clearly be perceived the discrepancy between public revenues and public expenditures. In all analyzed years public expenditures exceeded government revenues. Fiscal gap from year to year has been getting bigger. Data from Table 2 show that the gap was the lowest in 2007 (-1.9% of GDP), and the largest in 2012 (-6.6% of GDP). The most important, but not the only factor that caused this situation was the global economic crisis. However, the following determinants should not be ignored: the weak rule of law, high level of gray economy, high level of corruption, financial indiscipline, the discrepancy between monetary and fiscal policy, too extensive coalition of government and consequently large compromises, low credibility of the Prime Minister and members of the government, etc.

Table 2. The gap between public revenues and public expenditures as % of GDP in Serbia, 2007-2013

Year	Public revenues as % of GDP	Public expenditures as % of GDP	Deficit or suficit
2007	44,1	46,0	-1,9

2008	42,9	45,6	-2,7
2009	42,4	46,9	-4,5
2010	42,4	47,9	-5,5
2011	40,6	45,6	-5,0
2012	41,9	48,5	-6,6
2013	39,0	43,8	-4,8

Source: Bulletin of Public Finance, January 2014 Ministry of Finance of the Republic of Serbia, p.16-50, calculations have been carried out by authors

Public expenditures reflect the size of government and its past and present decisions regarding the redistribution of income and financing of public goods. They are, in fact, a government program that is wanted to be achieved in one-year period. From these program, we can see what the priorities of the government in certain period are. On the other hand, considering at the public revenue as % of GDP the downward trend has been spotted, despite the increment of tax rates in numerous taxes. The reason for this should be found in the booming of underground economy and in declining of the taxpayers purchasing power.

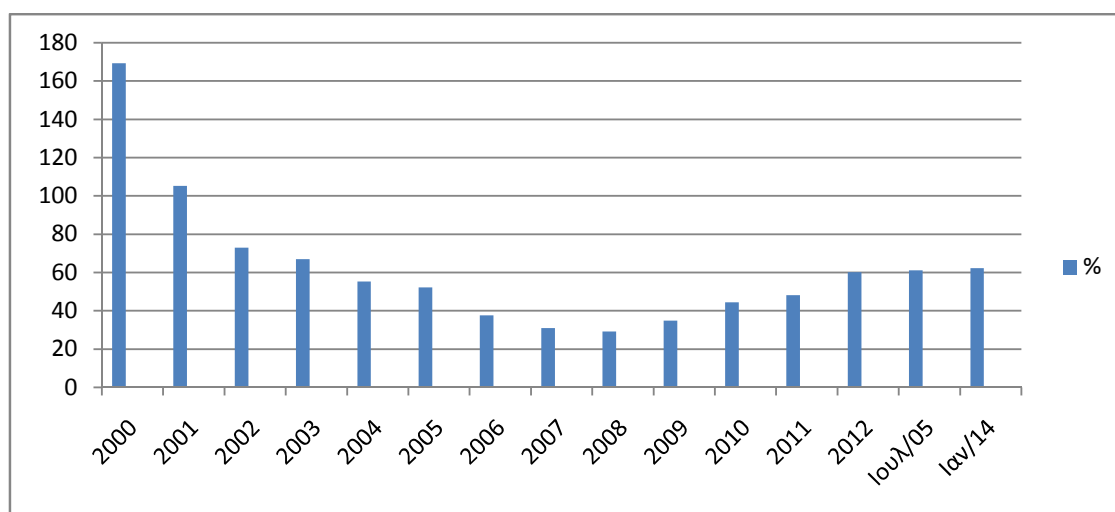


Figure 2 . Dynamics of public debt in Serbia as % of GDP, 2001-2014

Source: Bulletin of Public Finance, January 2014 Ministry of Finance of the Republic of Serbia, p.82

The burden of debt for the infirm Serbian economy is too big. The government is in a difficult situation, because it is forced to make big cuts on the expenditure side of the budget. As we can see from Fig. 2 the worst situation was at the beginning of the new millennium, as a direct result of the UN sanctions, the bombing of Serbia by NATO in 1999, when the infrastructure and many factories were destroyed. The best result was achieved in 2008, when the public debt reached a historically low level of 29.2% of GDP. In this year growth rate was high and privatization revenues were significant. Under the pressure of the economic crisis the legal limit of borrowing constraints at the level of 45% of GDP has been penetrated and the public debt began to grow rapidly.

Table 3. Relationship between current and capital expenditures in Serbia, 2005-2013

Year	Total expenditures – TE (mil.RSD)	Current expenditures – CuE (mil. RSD)	CuE/TE (%)	Capital expenditures – CaE (mil. RSD)	CaE/TE (%)
2005	705.194	651.539	92,4	45.866	7,6
2007	1.048.527	919.038	87,6	114.155	12,4
2009	1.267.905	1.154.156	91,0	93.270	9,0
2011	1.462.720	1.326.559	90,7	111.150	9,3
2013	1.649.074	1.552.378	94,1	84.023	5,9

Source: Bulletin of Public Finance, January 2014 Ministry of Finance of the Republic of Serbia, p.16-50, calculations have been carried out by authors

From the data in Table 3, we find that in the structure of total public expenditures current expenditures had dominant position, while the role of capital expenditure was marginal. 2005, as a starting year, had a very bad ratio between current and capital expenditures, as a result of the accumulated problems from the previous period. This was followed by a period of improvement of ratio in favor of capital expenditure, till the emergence of the economic crisis.

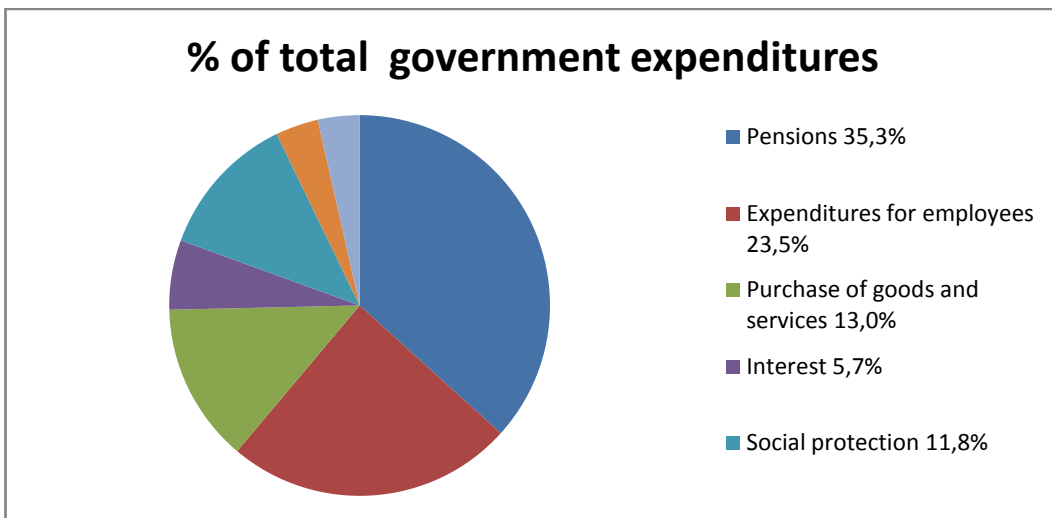


Figure 3. Structure of general government expenditures in Serbia, 2014

Source: Bulletin of Public Finance, January 2014 Ministry of Finance of the Republic of Serbia, p.16-50, calculations have been carried out by authors

The greatest pressure on the budget of the Republic of Serbia is caused by transfer of pensions. In 2014 they will represent more than a third of total consolidated expenditures. Ratio between the number of employees and the number of pensioners is very unfavourable (1:1). The Republic Fund for Pension and Disability Insurance barely manages to cover half of the expenditure for pensions from its own income. Therefore, it is necessary to provide the missing funds from the budget. Fig. 3 shows that the main part of total government expenditures are those for pensions with 35,3%. The following are expenditures for employees with 23,5% and almost 12% go to social protection.

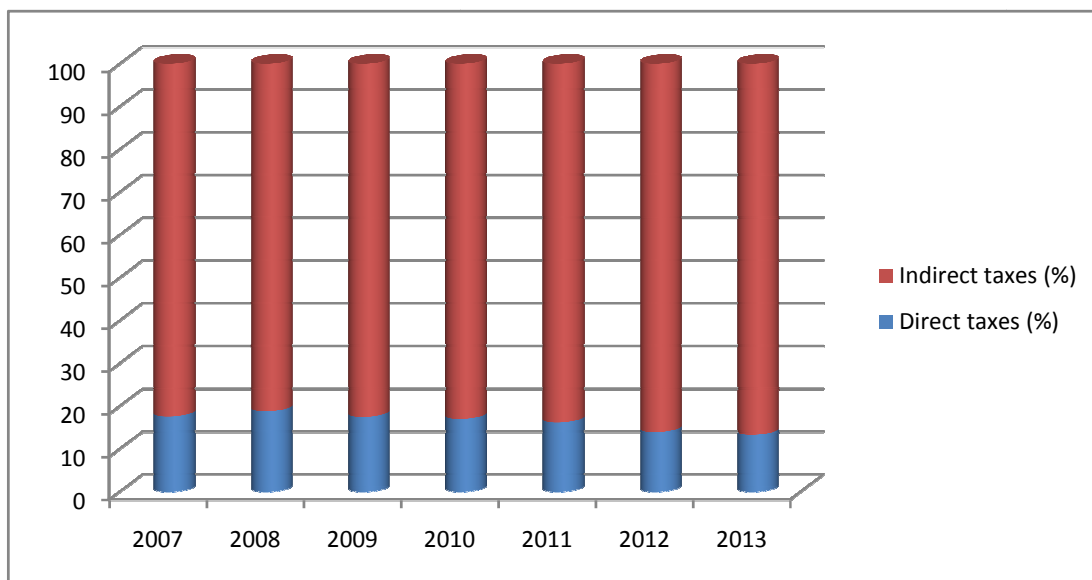


Figure 4. Relationship between direct and indirect taxes in Serbia, 2007-2013

Source: Bulletin of Public Finance, January 2014 Ministry of Finance of the Republic of Serbia, p.16-50, calculations have been carried out by authors

Fig. 4 shows that in Serbia exists a negative relationship between direct and indirect taxes. Direct taxes affect a taxpayers and as a rule they can not be transferred, while indirect taxes or consumption taxes are transferred through the price mechanism on consumers. Participation of indirect taxes goes up to almost 90%, which is the highest level in Europe. On the other hand, direct taxes note negative movement and don't go beyond 19%.

On the Fig. 5 we found that the largest single public income were social security contributions. Its share in 2013 was 28.5%. They are followed by revenues from VAT (25.9 %). On the third place were revenues from excises (13.9 %). As contributions do not belong to budget revenues, the structure of tax revenue in the budget of the Republic of Serbia is shown in Fig. 6. This figure shows that more than a half of the total tax revenues in Serbia are collected by VAT (52.6 %). Share of excises is 28.3 %, while customs participate with 4.5%. It is interesting to notice that the ratio of tax on personal income is almost twice as high in the consolidated revenues (10.6%) than in the total tax revenue (6.0%), because 80% of the tax on personal income goes to municipalities.

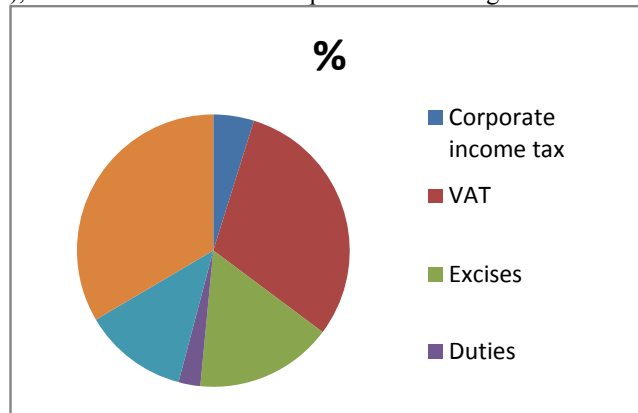


Figure 5. Structure of consolidated revenues in Serbia, 2013

Source: Bulletin of Public Finance, January 2014 Ministry of Finance of the Republic of Serbia, p.16-50, calculations carried by authors

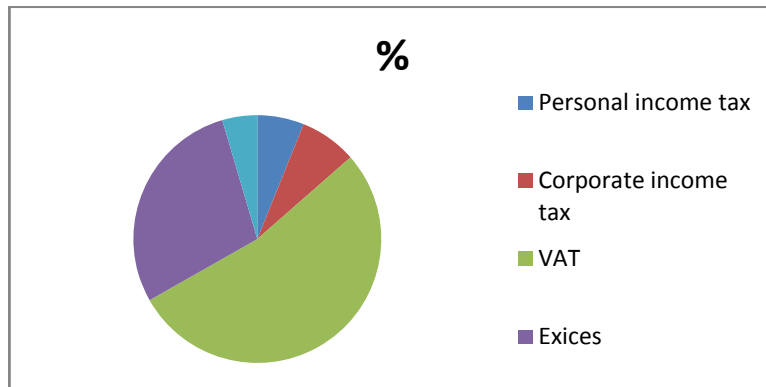


Figure 6. Structure of total tax revenues in Serbia, 2013

Source: Bulletin of Public Finance, January 2014 Ministry of Finance of the Republic of Serbia, p.16-50, calculations carried by authors

### 3. Fiscal consolidation measures on the revenue side of the budget and its results

For the successful implementation of fiscal consolidation is necessary to define and implement a set of fiscal rules. This set of measures is taken with the aim of reducing the budget deficit and government spending. Adequate rules for regulation level of the fiscal deficit and fiscal rules on public spending are crucial for successful public debt management. Fiscal rules should provide: a framework for conduct stable, predictable and sustainable fiscal policy,

equitable and sustainable distribution of costs and benefits between present and future generations and increase the credibility of macroeconomic policies. There are two basic types of fiscal rules. The first one is procedural (it defines the principles and procedures of decision-making process on fiscal policy without setting specific numerical limits for fiscal variables. Such an approach is used mainly in countries with strong institutions, where reputation of public policy is a significant and where the definition of the general rules is a part of the law tradition). The second one is numerical ( it defines the limits of fiscal variables: ratio of public debt , fiscal deficit and public spending to GDP ). The best solution is a combination of these rules. Fiscal rules set limits for fiscal policy in order to strengthen budget discipline, improve coordination between different levels of government and reduce uncertainty about future fiscal policy.

There are many reasons why government should introduce fiscal rules in Serbia. The most important are: the relatively weak institutions, the existence of extensive government coalition, pro-cyclicality of fiscal policy over the last decade, a risk of excessive growth of public debt in coming years.

Fiscal consolidation consists out of two types of measures: one is based on the reduction of public expenditure and the other on increasing of government revenues. Expenditure-based measures often take longer to fully implement, while increasing taxes can provide immediate gains. In EU countries fiscal consolidation is weighted on average two-thirds towards spending cuts and one-third towards increasing revenues. The proportion of consolidation attributed to expenditure-based measures is contingent on the fiscal situation in each country. If needed for fiscal sustainability, countries with a low tax burden have greater scope to implement consolidation through revenue enhancement measures (OECD Journal on Budgeting, p.18). Fiscal consolidation in Serbia has predicted a ratio of four to one in favour of a reduction of expenditure towards to increasing revenues. This proportion is proposed because of the international experience, which shows that a permanent recovery of public finances is achieved primarily by reducing expenditures and secondly, because public spending in Serbia is relative large to comparable countries (Proposed measures of fiscal consolidation from 2012 to 2016,p.3).

The Fiscal Council has proposed a tax reform which would achieve two objectives: first, changing the structure of income by shifting the tax burden from labour to consumption and second, preventing the reduction of tax revenues to GDP. A similar tax reform as response to the crisis in public finances, conducted a large number of countries, such as Germany, Hungary, France and Croatia. One important motive was fiscal devaluation, ie. reduction unit labour costs, which increases the international competitiveness of the economy and thus stimulate exports. On the other hand, the increase in the consumption tax leads to its inhibition and this causes reduction of import. Both of them help to turn economic growth from consumption and imports towards exports and investment. The aim of these measures is that the tax burden (about 40 % of GDP ) remains unchanged despite the increase in the tax rate, where the schedule of tax burden would significantly be changed - from those who invest and export to those who consume and import. In this sense, the following measures were taken:

Since October (2012):

- The general rate of VAT was increased from 18% to 20 % ,
- Cancelling the taxation at a special rate of 8 % for turnover of maintenance of streets, roads and other public areas and public lighting in towns and other resorts,
- Increase of VAT rate from 5% to 8 % and prescription of the obligation to pay VAT compensation to farmers only on their current account or savings account - the option of paying in cash was abolished,

Since January (2013):

- Census was increased for compulsory registration in the VAT system for total turnover from 4,000,000 to 8,000,000 dinars,
- Census was increased for determining of the monthly tax period for total turnover from 20 million to 50 million dinars,
- The deadline for filing tax returns was increased from 10 to 15 days for monthly taxpayers and for the three-month payers to 20 days from the expiration of the tax period.

Since 1. January 2014 special rate was increased from 8% to 10%, wherein computers and computer equipment were transferred to tax at the general rate of VAT.

Table 4. Nominal and real growth rate of VAT revenues in Serbia, 2007-2013

Year	VAT/TTR (%)	Growth rate of VAT revenues (%)	Rate of inflation (CPI) (%)	Real growth rate of VAT revenues
2007	51,9	-	11,0	-
2008	57,0	13,6	8,6	5,0
2009	51,7	-1,6	6,6	-8,2
2010	51,7	7,5	10,3	-2,8
2011	53,0	7,2	7,0	0,2
2012	53,5	7,3	12,2	-4,9
2013	52,6	3,6	2,2	1,4

Note: TTR – Total tax revenue

Source: Bulletin of Public Finance, January 2014 Ministry of Finance of the Republic of Serbia, p.16-50, calculations have been carried out by authors

Data in the table 4 show that the VAT revenues are the most important source of funds in the tax system of Serbia, because through the VAT it is collected over 50 % of total tax revenues. The nominal growth rates of revenues from VAT were always positive, except in 2009. In certain years the real growth rates of the VAT revenues noted its serious decline, but there were years when it realized positive growth rate. We found that an increase in the general VAT rate in 2012 didn't result in a real increase in tax revenues, primarily due to high inflation.

Amounts and rates of excises were also increased several times. Current amounts which have been applied from 1. January are the following: leaded gasoline 55,00 din / l; unleaded 50,00 din / l; gas oil 46.00 din / l; Kerosene 62.00 din / l; LPG 35.00 din / l; tobacco products 49 din / packs, alcoholic drinks from 19.58 to 297.52 din / lit and coffee from 80.00 to 300.00 \$ / kg .

Table 5. Nominal and real growth rate of excises revenues in Serbia, 2007-2013

Year	ER/TTR (%)	Growth rate of ER (%)	Rate of inflation (CPI) (%)	Real growth rate of ER (%)
2007	18,2	-	11,0	-
2008	19,0	7,9	8,6	-0,7
2009	20,8	19,1	6,6	12,5
2010	22,0	13,2	10,3	2,9
2011	23,6	12,4	7,0	5,4
2012	26,3	18,5	12,2	6,3
2013	28,3	13,4	2,2	11,2

Note: TTR – Total tax revenue, ER – Excise revenues

Source: Bulletin of Public Finance, January 2014 Ministry of Finance of the Republic of Serbia, p.16-50, calculations have been carried out by authors

Excise revenues had a permanent increasing share of total tax revenues (table 5). Nominal growth was fascinating. It is particularly important to note the fact that the real growth rate of excise revenues, was also positive. The highest growth was recorded in 2009 (12.5%) and 2013 (11.2%). Regarding the types of products most revenues have been collected from fuel taxation.

Unlike the consumption tax, certain direct taxes were reduced. With this changes tax rate on salaries was reduced from 12% to 10 % , while the tax-free amount was increased from 8,776 dinars to 11,000 dinars per month. Voluntary health insurance premium paid by the employer to employees was excluded from taxbase of salary (5,214 dinars per month).

Income from rental of real estate accordance with new changes is classified as income from capital. Tax rate is 20 % after the recognition of standardized costs of 25% ( 50 % for the issuance of travellers and tourists who had paid local taxes) . The tax rate on dividends is 15%. Amendments defined a new limit for revenues of self-employment tax on a lump sum basis. Instead of 3.000.000 dinars new limit is set at 6,000,000 dinars. New tax rate on capital income is 15 %, as well as, on capital gains. Farmers were exempt from paying taxes on income from



agriculture and forestry for 2013.

Analysing the table 6 we can see that in the observed period, the growth of total tax revenue in the budget of the Republic of Serbia was achieved in absolute terms and in nominal growth rate. However, when we consider inflation rate we notice that negative real growth rate was recorded. So, regardless of the increase in tax rates in almost all types of taxes, results were omitted. The share of total public revenues in GDP from year to year was smaller ( in 2012 this share had fallen to 39, 0 %, and the recovery observed in 2013 , when this ratio reached the amount of 43.8 % ) . Having the average rate of the fiscal burden in OECD countries of around 40 % ( OECD Economic Outlook), it is a clear signal that tax increases should not be used for further fiscal consolidation. The further increase in the tax burden would cause a rise in tax evasion and the underground economy.

Table 6. Nominal and real growth rate of total tax revenues in Serbia, 2008-2013

Year	Total tax revenues (mil.RSD)	Nominal growth rate (%)	Inflation rate (CPI) (%)	Real growth rate (%)
2007	511.261	-	11,0	-
2008	528.893	3,4	8,6	-5,2
2009	574.644	8,6	6,6	2,0
2010	616.608	7,3	10,3	-3,0
2011	646.598	4,9	7,0	-2,1
2012	686.823	6,2	12,2	-6,0
2013	723.390	5,3	2,2	3,1

Source: Bulletin of Public Finance, January 2014 Ministry of Finance of the Republic of Serbia, p.16-50, calculations have been carried out by authors

Since January 2014 a solidarity tax on salaries greater than 60,000 RSD in the public sector has been introduced. The amount of 60,000 to 100,000 RSD are taxed by rate of 20%, while the amount over 100,000 RSD are taxed by rate of 25%. In this way, university professors, medical specialists and other highly educated intellectuals are the most affected by new tax.

Fiscal consolidation measures in 2012, on the revenue side, didn't yield the expected results. Despite a significant increase in tax rates (VAT, excises, some part of income), aggregate demand is reduced, as a result of the fall in real household income (wages, pensions and other forms of social protection). At the same time a growth in the informal economy and illegal trade ( particularly in cut tobacco ) were reached. Stabilization of debt in the next period will be achieved by reducing the deficit, strict control of the issuance of new guarantees and granting for new project loans to finance large investment projects in the field of travel, gas and rail infrastructure, agriculture, energy, etc. On the other hand, privatization revenues from the sale and lease of state property, as well as favourable lending will be used for the early redemption of more expensive debt. That transactions in the following period would reduce overall cost of debt service (interest and principal). We should also note that there exists a new redistribution of the burden of contributions for pension and disability insurance. Until now, employers and employees have paid equal for this contributions (11%). In accordance with new measures, the burden is increased only for employees to 13%.

In addition to these measures, the fiscal council proposes increasement of the general rate of VAT to 22% and transfer of the non existential products (about a fifth) from the reduced to the standard rate, and increasement of excises on tobacco and alcoholic drinks, but not on fuel. They find that it is necessary to relieve employers in the field of contributions, in order to encourage employment. However, by opinion of the fiscal council most of the measures should be taken in the area of public expenditure, where they have proposed their sharp reduction.

#### 4. Fiscal consolidation measures on the expenditure side and the results

It is proposed to freeze (or strict indexation) wages and pensions, because they are the highest in the region and considerably higher than in the private sector. It is pointed out that it has been gone too far with fiscal decentralization, i.e. the Fiscal Council is of the view that participation of local government in revenues from taxes on salaries instead of 80%: 20% in favour of local governments should be equally divided. It is believed that previous reform has significantly reduced the amount of revenue collected from personal income tax in the budget of the Republic of Serbia.

It is also necessary to drastically reduce discretionary spending, because in them lies significant potential for irrational spending of budget funds. What is still necessary to carry out is the rationalization of public administration

employees. It should also reduce the number of agencies and extra-budgetary funds, which exceeds all permissible extent. In fact, some of them would be abolished and the others would connect with those who have similar functions. However, the burden of fiscal consolidation should not hit the most vulnerable. For example, the Fiscal Council recommends that the material conditional forms of welfare households and minimum pensions should be exempt from the freeze. In addition, we believe that it would be necessary to intensify social protection programs and implement decisive and indiscriminate fight against corruption, on both national and local level.

Table 7. Nominal and real growth rate of total budget expenditures in Serbia, 2008-2013

Year	Total budget expenditures (mil. RSD)	Nominal growth rate (%)	Inflation rate (CPI) (%)	Real growth rate (%)
2007	653.534	-	11,0	-
2008	740.826	13,3	8,6	4,7
2009	890.612	20,2	6,6	13,6
2010	1.058.635	18,8	10,3	8,5
2011	1.167.835	10,3	7,0	3,3
2012	1.288.922	10,4	12,2	-1,8
2013	1.396.229	8,3	2,2	6,1

Source: Bulletin of Public Finance, January 2014 Ministry of Finance of the Republic of Serbia, p.16-50, calculations have been carried out by authors

As it can be seen from the above table, in the budget of the Republic of Serbia is recorded a strong growth of total expenditure in absolute terms, but also in nominal terms. What is disturbing is the fact that in all years (except 2012), is noticed a significant increase in the real rate of growth of public expenditures, so as the logical consequence occurs a significant increase in public debt.

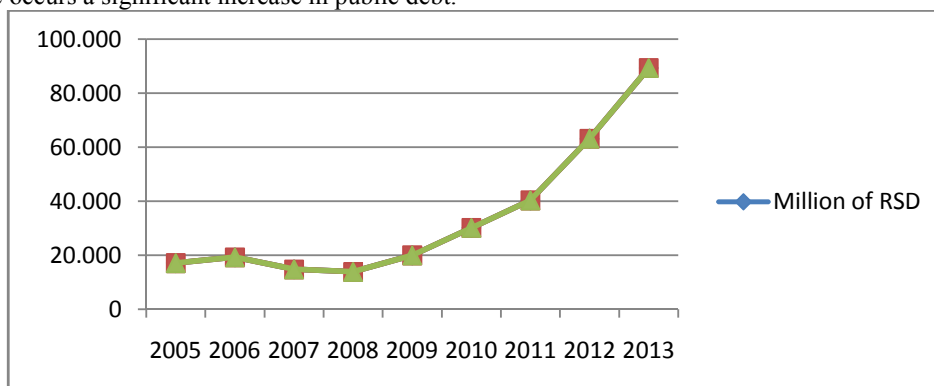


Figure 7. Expenditures for interest in budget of Republic of Serbia, 2005-2013

Source: Bulletin of Public Finance, January 2014 Ministry of Finance of the Republic of Serbia, p.16-50, calculations have been carried out by authors

From the above-mentioned data it is seen that the main source of deficit are reducing revenue and increasing expenses, which directly affects the further increase of the public debt. As a logical consequence of the increase in public debt, expenditure accrued interest also grow, which is evident from the Fig. 7.

In accordance with the proposed measures, the following table shows the movements of key macroeconomic variables in the period from 2014 to 2016. As we can notice for the next period of time, further real decline in private and public consumption are expected, but also a significant increase in investment spending, while the inflation is expected to move within the inflation corridor.

Table 8. Projection of the main macroeconomic indicators in the Republic of Serbia, 2014-2016

Variable/Year	2014	2015	2016
Real growth of GDP (%)	1,0	1,8	2,0
Real growth of private consumption (% of GDP)	-1,8	-0,6	-0,3
Real growth of public consumption (% of GDP)	-2,2	-4,4	-3,6
Investment	4,7	9,6	8,9
Expected inflation rate	5,5	5,0	4,5

Source: Fiscal strategy for 2014 with projections for 2015 and 2016, 2013, Government of Republic of Serbia, Belgrade, p.14

Table 9 shows two scenarios in the movement of fiscal aggregates as % of GDP for the analyzed period from 2014 to 2016. If the measures of fiscal consolidation weren't taken, the overall deficit and public debt would be closer to a risky level. Actually, they would turn to the red zone. According to the second scenario, the deficit would be reduced to a sustainable level, while public debt would still record a participation of almost 70%, which is a huge burden for the infirm Serbian economy.

Table 9. Movement of fiscal aggregates as a% of GDP with and without fiscal consolidation measures, 2014-2016

Fiscal aggregates	2014		2015		2016	
	Without measures	With measures	Without measures	With measures	Without measures	With measures
Public revenues	37,9	39,5	37,0	38,9	36,2	38,3
Public expenditures	44,9	45,0	44,5	43,1	43,1	40,6
Consolidated fiscal result	-6,9	-5,5	-7,5	-4,2	-6,8	-2,3
Total deficit	-8,6	-7,1	-8,4	-5,2	-7,7	-3,2
Public debt	70,9	67,2	74,9	69,8	77,4	69,7
Real growth rate of GDP	1,5	1,0	2,0	1,8	2,5	2,0

Source: Bulletin of Public Finance, January 2014 Ministry of Finance of the Republic of Serbia, p.16-50, calculations have been carried out by authors

And this is how the scenario of the Public Debt of Serbia would look like until 2022, if the fiscal consolidation was implemented.

Table 10. Simulation of public debt in Serbia until 2022

Basic scenario	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenues	43,4	43,8	43,9	43,5	43,5	43,5	43,5	43,5	43,5	43,5	43,5
Expenditures	50,2	47,3	45,8	44,5	44,2	44,0	43,8	43,7	43,6	43,6	43,5
Adapting to expenditure side		-2,9	-1,5	-1,3	-0,3	-0,2	-0,2	-0,1	-0,1	-0,1	0,0
Fiscal result	-6,8	-3,5	-1,9	-1,0	-0,7	-0,5	-0,3	-0,2	-0,1	-0,1	0,0
Public debt as % of GDP	65,1	65,2	58,7	58,4	56,2	54,3	52,4	50,5	48,6	46,8	45,0
Real growth rate of GDP	-1,0	2,0	3,5	4,0	4,0	4,0	4,0	4,0	4,0	4,0	4,0

Source: www.mogucasrbija.rs

Therefore, if it would be persevered and continued with disciplined long-term implementation of the measures taken and those yet to be carried out according to the scenario, stabilization of public debt and recurrence to the lawfully established level of 45% of GDP could be achieved until 2022.

## 5. Conclusion

In order to achieve macroeconomic stability and economic growth over the next three years, the government will change the way of guiding fiscal policy. This implies the adoption and implementation of credible fiscal consolidation program, which will provide a reduction in the fiscal deficit and stabilize the general government debt in 2016.

The main goals and priorities of fiscal policy in the future period are: lowering the ratio of public expenditure, fiscal deficit and public debt to GDP ; establishment of priorities in the funding of capital / investment projects in that the state will play very important role; strengthening fiscal discipline, which involves improving the system of tax collection and reducing the informal economy; consideration, in the medium term, a gradual shift of gravity of the tax policy from taxes of labour to other sources of tax revenue, and only in a manner that would certainly be at least balance neutral; strengthening the long-term fiscal sustainability through the implementation of structural reforms, especially reforms of the public sector .

Achieving the goals and priorities of fiscal policy will depend on the implementation of fiscal consolidation measures and key structural reforms in the further period, which are listed in the paper. In addition, the dynamics of fiscal consolidation should be harmonized, in order to avoid the annulment of the positive effects of the initiated investment cycle and trend changes in economic activity. During the reduction of budget expenditures, the attention will be paid to preservation of sources of potential growth and to the improvement of the efficiency of public

spending. Therefore, fiscal policy measures will be aimed at fiscal consolidation, which has a positive effect on economic growth and operates within the fiscal rules and adjustments on the revenue and expenditure side of the budget, and that leads to a reduction in the fiscal deficit.

A key role in fiscal sustainability in the medium term play the structural reforms of large and inefficient public sector, including the companies with the state share. In the next three fiscal years, implementation of fiscal consolidation measures are expected to ensure the reduction of the fiscal deficit and consequently public debt.

On the revenue side, it is provided the additional increase with the base in: the systematic suppression of the informal economy, the introduction of the percentage reduction of employee benefits in the public sector over certain thresholds (60,000 and 100,000 dinars), an increase in specific rates of value added tax from 8% to 10%, with the switch parts of non-essential products and services to the general VAT rate, an increase in collection of excise duties on tobacco through prevention of illegal trade in tobacco and tobacco products, and the abolition of relief for the corporation tax.

On the expenditure side, provided additional key measures are: a restrictive wage indexation of public sector and pensions, control and restrict supplements to salaries in the public sector, reduction of subsidies from the state budget and the budgets of local self-government through a review of existing subsidy programs, reducing expense on goods and services through rationalization and more effective control of procurement, reduction of interest expense arising from the refinancing of expensive debt to cheaper funds, increased spending on social welfare because of an increase in the number of welfare recipients and the amount of family welfare .

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